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INTERGOVERNMENTAL NEGOTIATING COMMITTEE
FOR A FRAMEWORK CONVENTION ON CLIMATE CHANGE
Tenth session
Geneva, 22 August - 2 September 1994
Item 4 (a) of the provisional agenda

MATTERS RELATING TO ARRANGEMENTS FOR THE FINANCIAL MECHANISM AND FOR TECHNICAL AND FINANCIAL SUPPORT TO DEVELOPING COUNTRY PARTIES

IMPLEMENTATION OF ARTICLE 11 (FINANCIAL MECHANISM), PARAS. 1-4

Agreed full incremental costs

Progress report by the interim secretariat

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I. INTRODUCTION

A. Committee mandate

1. At its ninth session, the Committee requested the interim secretariat to continue monitoring work carried out in the area of "agreed full incremental costs" taking into account also views expressed by Governments, and to keep the Committee informed of progress achieved.

B. Scope of the progress report

2. The report refers to elements relevant to "agreed full incremental costs" found in issues related to the financial mechanism, provides information on work carried out within the framework of the PRINCE Programme and mentions other activities in this area.

C. Possible action by the Committee

3. The Committee may wish to take note of this report and indicate what further work may be needed in this area.

II. BACKGROUND

4. "Agreed full incremental costs" are referred to in Article 4 (Commitments) of the Convention. Article 4.3 provides that the developed country Parties and other developed Parties included in Annex II shall provide new and additional financial resources, including for the transfer of technology, needed by the developing country Parties to meet the agreed full incremental costs of implementing measures that are covered by Article 4.1 and that are agreed between a developing country Party and the international entity or entities entrusted with the operation of the financial mechanism. (This commitment follows another for the funding of the agreed full costs incurred by developing country Parties in complying with their obligations under Article 12.1.)

5. The approach to calculating agreed full incremental costs will be important in determining the amount of funding to be received by the developing country Parties through the financial mechanism in support of their implementation of activities listed in Article 4.1. These will represent an important part of the implementation of the Convention as a whole. Incremental costs are thus relevant to financing policies, to cost-effective implementation of the Convention, and therefore to the determination of funding needs for the financial mechanism.

III. VIEWS EXPRESSED BY GOVERNMENTS

6. The issue of "agreed full incremental costs" was discussed at the eighth and ninth sessions of the Committee. It is addressed in a number of written submissions from Parties or other member States contained in documents A/AC.237/Misc.38 and A/AC.237/Misc.38/Add.1. The words "incremental costs" appear in document A/AC.237/Misc.38 in papers no.1 and no.2 of section A, paper no. 2 of section B and papers no. 1, 2, 3, 4, 5, 8 and 10 of section C, as well as in papers no. 1 and 2 of document A/AC.237/Misc.38/Add.1. It should, however, be noted that several of these submissions were made prior to the adoption of conclusions on this issue at the ninth session. Special attention is therefore drawn to the discussion of incremental costs with respect to adaptation measures in paper no. 2, section B of document A/AC.237/Misc.38 submitted by Trinidad and Tobago on behalf of the Alliance of Small Island States (AOSIS) and to the suggestion of a seminar discussion on incremental costs in paper no. 8 of section C of the same document submitted by Sweden, which were both submitted after the ninth session.

IV. ACTIVITIES CARRIED OUT IN THE AREA OF "AGREED FULL INCREMENTAL COSTS"

A. The PRINCE programme

7. The Program for Measuring Incremental Costs for the Environment (PRINCE) was initiated and is managed by the Administrator's Office of the Global Environment Facility (GEF). Advice in its operation is provided by a Policy Advisory Group (in which the FCCC Secretariat participates) and an Implementation Advisory Group. PRINCE studies the technical aspects of incremental costs, the costs actually incurred as a result of measures to protect the global environment, as distinct from financing policy in regard to those costs.

8. Activities undertaken under the PRINCE programme fall into three categories:

(i) Methodological studies;

(ii) Case studies or field tests; and

(iii) Training and outreach.

9. Methodological studies: Most studies have been and will continue to be in the climate change and biodiversity areas, with an initial emphasis on project and sector level work. Some work will also be undertaken on international waters and ozone depletion (two other focal areas of the GEF) and on projects with simultaneous benefits for more than one focal area.

10. In the area of climate change, methodological studies will be conducted in the forthcoming period with regard to:

(a) The electric power sector;

(b) The urban transport sector;

(c) Renewable energy technologies;

(d) Carbon sinks;

(e) Adaptation measures; and

(f) Economy-wide incremental costs.

11. In cross-cutting areas, methodological studies are proposed with respect to:

(a) The incremental costs of capacity building;

(b) Processes on reaching agreement on incremental costs; and

(c) Discounting.

12. Case studies in climate change: Case studies have been conducted by power utilities in Latin America. GEF pilot phase and pipeline projects are proposed to be used as additional case study material.

13. Training and outreach: It is proposed that the results of the proposed methodological studies will be widely disseminated through training programmes and in the form of working papers which will eventually be compiled in a compendium.

14. Training packages will be developed, using appropriate combinations of printed, computer assisted and videotaped materials. GEF, in cooperation with the Implementing Agencies will develop operational guidance for their use using technical outputs of the programme.

15. Regional "centres of excellence" in developing countries collaborate with GEF on the PRINCE programme in all its activities. GEF intends to establish long term relationships with these centres.

16. Information on the incremental cost framework will be disseminated in recipient countries by the United Nations Development Programme (UNDP), with the collaboration of PRINCE staff in the preparation of training materials for government negotiations. The development of training manuals, expert systems on various issues related to incremental costs and of global environmental modules for addition to existing curricula on power system planning courses will be undertaken in collaboration with developed and developing country institutions.

B. Other activities relevant to "agreed full incremental costs" brought to the attention of the interim secretariat

17. The office within UNDP that acts as the focal point for the GEF has commissioned a consultancy on the application of the incremental cost approach to capacity building activities.

18. A study entitled "The Costs of Incremental Costs, Consequences for GEF/UNDP Project Evaluation" has been prepared by the School of International and Public Affairs of Columbia University, New York, USA.

19. A study entitled "Incremental Costs and The Global Environment Facility, A WWF Assessment", authored by David Reed and Amanda Wolf, has been published by the WWF International Institutions Policy Program, World Wide Fund for Nature (WWF), Washington DC, USA.

20. A study entitled "Reframing the Green Window: An analysis of the GEF Pilot Phase Approach to Biodiversity and Global Warming and Recommendations for the Operational Phase" has been published by the Conservation International and the Natural Resources Defense Council, Washington DC, USA.

21. An article entitled "Additional Funds, Incremental Costs and the Global Environment" by Andrew Jordan and Jacob Werksman, is to appear in the Review of the European Community and International Environmental Law, published by the Foundation for International Law and Development, London, United Kingdom.

22. A significant number of studies and documents have also been prepared with respect to the application of the incremental cost approach to the areas of ozone depleting substances and the conservation of biodiversity.

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MATTERS RELATING TO ARRANGEMENTS FOR THE FINANCIAL MECHANISM AND FOR TECHNICAL AND FINANCIAL SUPPORT TO DEVELOPING COUNTRY PARTIES

IMPLEMENTATION OF ARTICLE 11 (FINANCIAL MECHANISM), PARAS. 1-4

CONSIDERATION OF THE MAINTENANCE OF THE INTERIM ARRANGEMENTS REFERRED TO IN ARTICLE 21, PARA. 3

Modalities for the functioning of operational linkages between the Conference of the Parties and the operating entity or entities of the financial mechanism: legal opinion of the United Nations Office of Legal Affairs

Note by the interim secretariat

INTRODUCTION

A. Committee mandate

1. At the eighth session of the Committee, the interim secretariat was requested to seek the opinion of the United Nations Office of Legal Affairs on arrangements which might be entered into between the Conference of the Parties (COP) and the operating entity or entities of the financial mechanism of the Convention (A/AC.237/41, para. 88).

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2. The Committee at its ninth session took note of the legal opinion offered, which had concluded that it was "not feasible to determine in general which arrangements should be considered as appropriate between the COP and a hypothetical operating entity" (A/AC.237/55, para. 92). This was because an instrument for the establishment of the restructured Global Environment Facility (GEF), the international entity entrusted with the operation of the financial mechanism on an interim basis, was still being negotiated and it was not clear then what the final structure was going to be.

3. The Committee requested the interim secretariat to seek further advice from the United Nations Office of Legal Affairs on the options for such arrangements, based on the final GEF instrument, in time for discussion by the Committee at its tenth session.

B. Scope of the note

4. The annex to this note contains the legal opinion of the United Nations Office of Legal Affairs on the appropriate arrangements that might be entered into between the COP and the GEF. The legal opinion is based on the "Instrument for the establishment of the restructured GEF" accepted by the Participants in the GEF at Geneva on 16 March 1994 and subsequently adopted by the United Nations Development Programme (UNDP), the United Nations Environment Programme (UNEP) and the World Bank.

C. Possible action by the Committee

5. The Committee has, since its seventh session, been considering how the financial mechanism referred to in Article 11 is to be implemented. It has reached some conclusions on the following issues:

(a) Policies, programme priorities and eligibility criteria;

(b) Agreed full incremental costs; and

(c) Modalities for the functioning of operational linkages between the COP and the operating entity or entities of the financial mechanism.

6. The Committee at its ninth session decided to give further consideration to the above-mentioned issues at its tenth session (see A/AC.237/55, para. 93).

7. With respect to the legal opinion, the Committee may wish to focus its attention on issues relating to the modalities for the functioning of operational linkages between the COP and the operating entity or entities of the financial mechanism. On this subject, the legal opinion states, inter alia, that "complex issues such as accountability, observance of compliance with the eligibility criteria for funding, procedures for the reconsideration of particular funding decisions and, last but not least, procedures for joint determination and periodical review of the aggregate GEF funding necessary and available for the implementation of the Convention, will have to be regulated in an
agreement concluded for these purposes. In other words, in order to ensure the effective operation of the GEF as a source of funding of the activities under the Convention, the above-captioned issues should be spelled out in a legally-binding treaty instrument" (see annex, para. 16). In this connection, the Committee may wish to consider:

(a) The contents of such an instrument; and

(b) How it is to be negotiated with the GEF,

and make recommendations thereon to the COP.

8. The above considerations are related to the question of the maintenance of the interim arrangements referred to in Article 21, para. 3. The Committee may also wish to take the legal opinion into account when considering this question under its agenda item 4(b).

Annex

MEMORANDUM OF 23 AUGUST 1994 TO THE EXECUTIVE SECRETARY FROM MR. HANS CORELL, UNDER-SECRETARY-GENERAL FOR LEGAL AFFAIRS, THE LEGAL COUNSEL

Arrangements between the Conference of the Parties of the United Nations Framework Convention on Climate Change and the Global Environment Facility

Introduction

1. This is in response to your memorandum of 11 April 1994 which conveys a decision of the Intergovernmental Negotiating Committee for a Framework Convention on Climate Change (INC/FCCC) requesting the interim secretariat of the Committee to seek the advice of this Office concerning the options for appropriate arrangements which might be entered into between the Conference of the Parties and the Global Environment Facility (GEF). In this connection it is pointed out in your memorandum that the GEF has recently gone through a restructuring and that "at the meeting of the GEF Participants held at Geneva from 14 to 16 March 1994, agreement was reached on the instrument establishing the GEF". It is further indicated in your memorandum that the above legal opinion is requested to facilitate the work of the INC/FCCC at its tenth session scheduled for 22 August to 2 September 1994 at Geneva.

Criteria established by the United Nations Framework Convention on Climate Change for the selection of an entity entrusted with the operation of a financial mechanism

2. Under Article 11, paragraph 1, of the United Nations Framework Convention on Climate Change (hereafter referred to as "the Convention"), a financial mechanism is defined to provide financial resources for the implementation of the Convention. According to the Convention, the operation of the financial mechanism shall be entrusted to one or more existing international entities. The Convention requires that the financial mechanism and, therefore, an entity or entities entrusted with its operation, should meet the following criteria:

- It shall function under the guidance of and be accountable to the Conference of the Parties, which shall decide on its policies, programme priorities and eligibility criteria related to this Convention;
- It shall have an equitable and balanced representation of all Parties within a transparent system of governance.

3. The Convention further provides in paragraph 3 of Article 21 that the Global Environment Facility established as a pilot programme by resolution 91-5 of the Executive Directors of the International Bank for Reconstruction and Development (the World Bank), dated 14 March 1991, shall be the international entity entrusted with the operation of the financial mechanism referred to in Article 11 on an interim basis and that, meanwhile, the GEF should be appropriately restructured and its membership made universal to enable it to fulfil the requirements of Article 11 of the Convention.

Legal nature of the restructured GEF

4. The restructured GEF was established in accordance with the Instrument which, having been accepted by the representatives of the States participating in the GEF at their meeting in Geneva, Switzerland (14-16 March 1994), shall be adopted by the Implementing Agencies (UNDP, UNEP and the World Bank) in accordance with their respective rules and procedural requirements (paragraph 1).

5. The above provision means that, in order to become legally effective, the Instrument should be approved by the parallel decisions of the governing bodies of the Implementing

Agencies. Paragraph 34 of the Instrument provides that it could be amended or terminated only by similar parallel decisions of the Agencies.

6. The above provisions of the GEF Instrument show that the restructured GEF constitutes an entity established by the World Bank and the United Nations, acting through UNDP and UNEP, as defined in the Instrument. As such, the restructured GEF is a new entity which is distinct from the former GEF, which, as noted above, was established as a pilot programme of the World Bank by resolution 91-5 of its Executive Directors.

The question whether the restructured GEF meets the criteria referred to in paragraph 1 of Article 11 of the Convention

7. It should be noted from the very outset that the GEF Instrument states in set terms that the GEF shall be available to serve as the financial mechanism for the implementation of the Convention, if it is requested to do so by the Conference of the Parties (COP), which is the principal organ of the Convention (paragraph 6).

8. With reference to the first criterion established by the Convention, the Instrument provides in paragraph 6 that if the GEF is selected by the COP to serve as an entity entrusted with the operation of the financial mechanism, the GEF shall function under the guidance of, and be accountable to, the COP which shall decide on policies, programme priorities and eligibility criteria for the purposes of the Convention. This commitment is reaffirmed in paragraphs 15 and 26 of the Instrument which imply that within the governance structure of the GEF, its Council is an organ

which is responsible for ensuring that the use of GEF resources for the purposes of the Convention shall be in conformity with the policies, programme priorities and eligibility criteria decided by the COP. In defining the eligibility criteria for the GEF funding, the Instrument makes it clear that GEF grants that are made available within the framework of the financial mechanism of the Convention shall be in conformity with the eligibility criteria decided by the COP (subparagraph 9 (a)).

9. As far as the second requirement is concerned, it is stressed in preambular paragraph (c) of the Instrument that the restructured GEF is established to ensure a governance that is transparent and democratic in nature and to promote universality in its participation. In accordance with paragraph 7 of the Instrument, participation in the GEF is open to any State member of the United Nations or of any of its specialized agencies. The States which have expressed their desire, in a form defined by the Instrument, to participate in the activities of the GEF are called "Participants" (paragraph 7). The Assembly of the GEF is composed of representatives of all Participants (paragraph 13) and the membership of the Council is structured in such a way as to ensure that the seats are distributed taking into account the need for balanced and equitable representation (paragraph 16).

10. Furthermore, paragraph 25 of the Instrument stipulates that the Assembly and the Council shall each adopt by consensus regulations to perform their respective functions transparently. According to paragraph 31 of the Instrument, an annual report on the activities of the GEF shall contain all the information necessary to meet the principles of accountability and transparency that shall characterize the Facility.

11. In the light of the foregoing, it may be concluded that the restructured GEF is an entity which meets the requirements set forth in paragraph 1 of Article 11 of the Convention and, therefore, may be selected by the COP as an entity entrusted with the operation of the financial mechanism.

Requirements of the Convention regarding the elements which should be covered in arrangements between the Conference of the Parties and an operating entity

12. Irrespective of whether the restructured GEF or any other entity is asked by the COP to operate the financial mechanism, the Convention requires in paragraph 3 of Article 11 that the COP should enter into arrangements with such an entity which shall include the following elements:

"(a) Modalities to ensure that the funded projects to address climate change are in conformity with the policies, programme priorities and eligibility criteria established by the Conference of the Parties;

(b) Modalities by which a particular funding decision may be reconsidered in light of these policies, programme priorities and eligibility criteria;

(c) Provision by the entity or entities of regular reports to the Conference of the Parties on its funding operations, which is consistent with the requirement for accountability set out in paragraph 1 above; and

(d) Determination in a predictable and identifiable manner of the amount of funding necessary and available for the implementation of this Convention and the conditions under which that amount shall be periodically reviewed."

Provisions of the GEF Instrument relating to the requirements for arrangements set forth in paragraph 3 of Article 11 of the Convention

13. As noted above, the GEF Instrument contains a general statement of principle providing that the use of GEF resources for the purpose of the Convention shall be in conformity with the policies, programme priorities and eligibility criteria decided by the COP (paragraphs 6, 20 (h), and 26). With reference to the occasions where the GEF serves as the financial mechanism of the Convention, the Instrument obliges the Council, as an organ responsible for the operational policies and programmes for GEF-financed activities, to act in conformity with the policies, programme priorities and eligibility criteria decided by the COP. Paragraph 31 of the Instrument also provides that an annual report on the activities of the GEF, which shall be approved by the Council and then serve as a basis for review and evaluation of the operation of the Facility by the Assembly, shall meet the requirements arising from the reporting arrangements agreed with the COP.

14. At the same time, it should be pointed out that the GEF Instrument is based on the assumption that particulars of the implementation of the aforementioned general policy will be defined through the conclusion of a cooperative arrangement (arrangements) or agreement (agreements) with the COP. According to the Instrument, such an arrangement (arrangements) or agreement (agreements) shall address, inter alia, the following issues: procedures governing receipt of guidance and recommendations from the COP (paragraph 20 (g); reciprocal representation in meetings (paragraph 27); reporting requirements to the Conference of the Parties (paragraph 31) and procedures ensuring compliance with such requirements (paragraph 20 (g)); procedures for determining jointly the aggregate GEF funding requirements for the purpose of the Convention (paragraph 27).

Options for appropriate arrangements which might be entered into between the Conference of the Parties and the restructured GEF as an operating entity

15. It should be observed that although there are certain similarities between the list of issues referred to in paragraph 3 of Article 11 of the Convention and the list of issues proposed for

inclusion into a cooperative arrangement or agreement in the GEF Instrument, these two lists are not identical. Moreover, analysis of these two lists gives reason to believe that under the Convention it is expected that the COP should play a slightly more active role in exercising control over the implementation of the policies, programme priorities and eligibility criteria established by the COP, than it is envisaged for it in the GEF Instrument.

16. In summary, it could be pointed out that it should not be completely excluded that practical questions related to the reporting procedures, as well as arrangements for reciprocal representation in meetings of the COP and the GEF could be worked out without difficulty through the inclusion of necessary provisions in the respective rules of procedure. However, it could hardly be anticipated that the aforementioned discrepancies between the two instruments, however minor they might be, and other complexities, which might arise in the course of negotiations, would be straightened out at a working level. It may be stated with sufficient certainty that complex issues, such as accountability, observance of compliance with the eligibility criteria for funding, procedures
for the reconsideration of particular funding decisions and, last but not least, procedures for joint determination and periodical review of the aggregate GEF funding necessary and available for the implementation of the Convention, will have to be regulated in an agreement concluded for these purposes. In other words, in order to ensure the effective operation of the GEF as a source of funding of the activities under the Convention, the above-captioned issues should be spelled out in a legally-binding treaty instrument.

17. The GEF Instrument provides that within the governance structure of the GEF, the Council shall act as the focal point for the purpose of relations with the COP (paragraph 20 (g)). Functions of the Council include responsibility for the consideration, approval and review of the cooperative arrangements or agreements with the COP (paragraphs 20 (g), and 27).

18. At the same time, it should be pointed out that the GEF is a subsidiary body of the World Bank and the United Nations, acting through UNDP and UNEP, and while its organs have considerable authority in governance of the GEF activities, the founders of the restructured GEF did not provide it with the legal capacity to enter into legally binding arrangements or agreements.

19. It follows from paragraph 7 of Annex B to the GEF Instrument that cooperative arrangements and agreements that have been considered and approved by the Council, will then have to be formalized by the World Bank. Thus, if a cooperative arrangement or agreement is negotiated by the GEF with the COP, subsequently it will have to be formalized by the World

Bank. In most cases, such formalization should not create any complications. However, under the Instrument, such formalization remains a legal requirement.

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